



Office of the Washington State Auditor
Pat McCarthy

Fraud Investigation Report

Employment Security Department

For the investigation period January 1, 2020, through December 31, 2020

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**Office of the Washington State Auditor
Pat McCarthy**

December 6, 2021

Commissioner
Employment Security Department
Olympia, Washington

Report on Fraud Investigation

Attached is the official report on a misappropriation at the Employment Security Department. On October 27, 2020, the Department notified the Office of the Washington State Auditor of a potential loss of public funds. This notification was submitted to us under the provisions of state law (RCW 43.09.185).

This report contains the results of our investigation of the former Unemployment Insurance Specialist's unallowable activities at the Department from January 1, 2020, through December 31, 2020. The purpose of our investigation was to determine if a misappropriation had occurred.

Our investigation was performed under the authority of state law (RCW 43.09.290) and included procedures we considered necessary under the circumstances.

If you are a member of the media and have questions about this report, please contact Director of Communications Kathleen Cooper at (564) 999-0800. Otherwise, please contact Special Investigations Program Manager Stephanie Sullivan at (360) 688-0858.

Olympia, WA

cc: Benjamin Hainline, Director of Internal Audit

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FRAUD INVESTIGATION REPORT

Investigation Summary

On October 27, 2020, the Department notified our Office regarding a potential loss of public funds, as required by state law (RCW 43.09.185). Our investigation determined a misappropriation of unemployment insurance benefit funds occurred at the Department, totaling \$315,282, and that the Department made an additional \$121,503 in questionable payments related to this situation between January 1, 2020, and December 31, 2020.

The Department also referred the case to the U.S. Department of Labor's Office of Inspector General (OIG) and the Federal Bureau of Investigation (FBI) for investigation.

Background and Investigation Results

The Department's operating budget before the pandemic was about \$400 million. The Department administers programs authorized under the federal Workforce Innovation and Opportunity Act, the state's Paid Family Medical Leave program, and the state's unemployment insurance program. The Department's Fraud Management Division review any potentially illegitimate claims, and payments are processed by the Financial Services Division. In 2020, the Department distributed more than \$13.6 billion in unemployment benefits.

In October 2020, the Department received a tip from Child Support Enforcement regarding an illegitimate unemployment insurance claim for a claimant. It was found \$18,345 had been filed and paid using the claimant's name. An Unemployment Insurance Specialist (Specialist), who was on temporary assignment to help the Department process an influx of claims during the pandemic, processed the claim. The Department determined the Specialist was related to the claimant.

The Department terminated the Specialist's employment and initiated an investigation to determine if he used his position to misappropriate additional claims. The Department generated a report from the state's Unemployment Benefit Tax and Benefit System (UTAB) of all claims "touched" by the Specialist. Of the 969 claimant accounts touched, totaling \$14,277,070 in payments, the Department flagged \$364,759 of these payments as unusual.

The Department gave its investigation results to our Office, the OIG and the FBI for further investigation into the claims.

On September 24, 2021, the Department of Justice (DOJ) released an indictment based on the results of the OIG and FBI investigations. The indictment said the Specialist distributed at least \$360,000 in illegitimate claims and personally benefitted from at least \$130,000 of those claims by:

- Filing illegitimate claims to be disbursed to debit cards, and having the cards mailed to addresses where the Specialist had access to retrieve the cards
- Accepting bribes in exchange for making false entries on claims for family, friends and acquaintances, many of whom were ineligible for benefits
- Extorting claimants by threatening to terminate benefit payments if they did not pay him

The Specialist now faces 20 federal charges for the illegitimate claims.

For our investigation, we reviewed the indictment and the Department's investigation files, including the UTAB accounts for all flagged claimants. We determined the Specialist misappropriated at least \$315,282 between January 1, 2020, and December 31, 2020. We also identified an additional \$121,503 in questionable payments, which we are unable to verify it represents misappropriation or not, associated with this person during the same period.

Further, during our review of the Specialist's activity in the UTAB system, we found:

- Instances where the Specialist changed claimant address and payment method information. Sometimes the same address showed up on various claimant accounts, and many claimants had a debit card or an online bank designated as their payment method, suggesting the possibility payments were diverted or "hijacked." No one reviewed the Specialist's changes to confirm they were legitimate.
- Instances where it appeared the Specialist may have processed claims for ineligible claimants, including people who were incarcerated or had no wage history. No one reviewed these claims to verify the Specialist's decisions to allow payments.
- An instance of questionable documentation being used to verify claimant identity, including a fake Social Security card. Once the Department's system verifies an identity, the claim is released and payment is sent.

Our Office did not interview the Specialist because he is in law enforcement custody. However, the OIG and FBI did interview him around the time of the September 2021 indictment. At the time of our report, records of that interview were not available for our review.

Control Weaknesses

The Department's internal controls were inadequate to detect and prevent occupational misappropriation and safeguard public resources. We found the Department did not properly monitor and review claims to ensure benefit payments were legitimate and to avoid a loss of public funds. No one at the Department performed secondary reviews of claimant account changes or eligibility decisions made by unemployment insurance specialists. These control weaknesses increase the risk that:

- Unemployment benefit payments are diverted for personal benefit, and
- Claimants receive unemployment benefits they are not eligible for.

Additionally, we noted an instance when the Department used questionable documentation to verify identity and to make the determination that payment made to a claimant was "allowable." This indicates the Department's identity verification process may not be adequate to ensure only legitimate claimants receive unemployment benefits.

Recommendations

The Department has taken steps to improve its control structure. However, we continue to recommend the Department:

- Improve monitoring of employee activity, such as adding a secondary review of claimant benefit decisions and account changes, to ensure benefit payments are legitimate and made to only eligible recipients, and occupational loss can be detected and prevented.
- Improve the fraud prevention portfolio to identify known or potentially illegitimate claims accurately and promptly, such as for people who are incarcerated or have no wage history
- Improve the identity verification processes to ensure claimants provide sufficient, valid proof of their identities, such as adding a secondary review of identity decisions made by Department staff

We also recommend the Department seek recovery of the misappropriated \$315,282 and related investigation costs of \$15,000 from the former Unemployment Insurance Specialist and/or its insurance bonding company, as appropriate. Any compromise or settlement of this claim by the Department must be approved in writing by the Attorney General and State Auditor as directed by state law (RCW 43.09.330). Assistant Attorney General Matt Kernutt is the contact person for the Attorney General's Office and can be reached at (360) 586-0740 or Matthew.Kernutt@atg.wa.gov. The contact for the Office of the Washington State Auditor is Brandi Pritchard, Assistant Director of Local Audit and Special Investigations, who can be reached at (360) 489-4591 or Brandi.Pritchard@sao.wa.gov.

Department's Response

The Employment Security Department (Department) sincerely appreciates the feedback received from the State Auditor's Office (SAO) and will make necessary changes to improve our internal control structure to better detect and prevent occupational misappropriation.

The Department will take the following actions:

- Implement varying control activities that can help detect and prevent future employee fraud such as conducting quality review checks of employee activity. This review will consist of ongoing sampling of case work. A complete review of all claims would not be manageable and would essentially require that claims be worked twice, which would negatively impact our ability to pay legitimate claimants in a timely manner.*
- Provide training sessions to employees in order to educate staff on negative impacts of internal fraud and possible consequences, in order to enhance and protect Department's value and mission.*
- Department will work with the prosecutor to ensure that if the Specialist is convicted, restitution is imposed so that a mechanism is in place to recover any funds possible.*

Clarification

The Department would like to clarify SAO's findings regarding the review of the Specialist's activity in the UTAB system. On the second listed finding, SAO identified "Instances where it appeared the Specialist may have processed claims for ineligible claimants, including people who were incarcerated or had no wage history", the second part of this section regarding "no wage history" does not represent a red flag during this period due to the CARES Act which was implemented on March 27, 2020.

It is also important to note that the identified questionable payment figure of \$121,503, has been reviewed by the Department's Office of Special Investigations since the time of this audit and it has been determined that three (3) claims totaling \$37,862 were legitimate and should not be classified as questionable.

On March 27, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law. The CARES Act in turn created the Pandemic Unemployment Assistance (PUA) program.

This program offers unemployment assistance to classes of workers, such as those who are self-employed or working part time, not normally eligible for regular unemployment compensation. PUA allows eligibility for these people if they are not considered able and available for work for reasons related to the coronavirus pandemic, without the typical verifications required for regular unemployment benefits.

Additional Measures Not Previously Mentioned

The Department is fully committed to the ongoing efforts to serve Washingtonians and to protect the unemployment trust funds from illegitimate claimants. The Department identified the quality assurance group which is responsible for the timely and thorough completion of federally mandated audit function for the UI program. The group is comprised of staff that perform Benefit Accuracy Measurement (BAM) audits, Tax Performance Systems (TPS) reviews, and the State Quality Service Plan.

The BAM audits both paid and denied UI claims and BAM is part of the UI Performance Management. TPS Unit is part of the U.S. Department of Labor's UI Performance program. This program is a comprehensive performance management system in which state and federal government work together to improve the quality of unemployment tax services to employers and unemployed workers.

Closing

The Department deeply appreciates the role of the SAO and extremely grateful for the recommendations and guidance provided to the Department.

Auditor's Remarks

The Office of the Washington State Auditor re-affirms its findings. We will continue to audit the Department and follow up on internal controls related to unemployment insurance benefits. We thank Department officials and personnel for their assistance and cooperation during the investigation.

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